BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
HUGH S. AND NINA J. LIVIE, CHARLES E.)
AND RUTH A. HOPPING, AND KENNETH M.)
AND GRACE I. BISHOP)

Appearances:

For Appellants: Bernard E. Jacob and Norman B. Barker, Attorneys at Law

For Respondent: Crawford H. Thomas; Associate Tax Counsel

O P I N I O N

These appeals are made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Hugh S. and Nina J. Livie, Charles E. and Ruth A. Hopping, and Kenneth M. and Grace I. Bishop against proposed assessments of additional personal income tax in the amounts of $17,459.66, $17,417.17 and $17,585.63, respectively, for the year 1960.

A single question is presented by these appeals, i.e., whether or not appellants are entitled to a credit against their 1960 California personal income tax liability for Puerto Rican net income tax which they paid on a liquidating dividend received from a Puerto Rican corporation in that year. Because of the substantial identity of facts, issue, and legal principles involved in each case, the three appeals are consolidated for purposes of this opinion.

In 1953, Hugh S. Livie, Charles E. Hopping, and Kenneth M. Bishop (hereafter "appellants") formed a corporation in compliance with the laws of Puerto Rico. At that time each of the three appellants acquired approximately one-third of the out standing capital stock of the new organization, Roberts

Corporation. The corporation operated a factory in Puerto Rico 'and shipped its products for sale throughout the United States. On January 11,1960, Roberts Corporation was dissolved and its assets were distributed to appellants, subject to' its remaining liabilities, in exchange for appellants* stock. During Roberts Corporation's entire existence, and at the time of its dissolution,,?': appellants were residents and domiciliaries of California.

Under Puerto Rican law a nonresident stockholder in a Puerto Rican corporation is liable for a net income tax on 'any gain realized on such stock which constitutes income derived from sources within Puerto Rico, (See §§ 11, 22(a), 115(c) and 119(a)(2) of the Puerto Rican Income Tax Act of 1954, Puerto Rican Tax Reporter Service, Vol. 1, Foreign Tax Law Association, Inc,) The liquidation and distribution to appellants of the assets of the Roberts Corporation resulted in substantial gains to them as its shareholders. Puerto Rico characterized those gains as having been derived from Puerto Rican sources, and appellants reported and paid tax on them in their 1960 Puerto Rican income tax returns,

Subsequently appellants and their wives filed joint California personal income tax returns for 1960, in which each claimed a credit for the Puerto Rican net income' tax he had paid in that year., Respondent disallowed the credits on the ground that the gains were not derived from Puerto Rican sources within the meaning of our tax credit statute.. Notices of proposed additional assessment were Issued.' and these appeals are taken from respondent's denial of appellants' protests against those additional levies.

Section 18001 of the Revenue and Taxation Code provides, in',, part:

> Subject to the following conditions, residents shall be allowed a credit against the taxes imposed by this part for net income taxes imposed by and paid to another state on income taxable under this part:
>
> (a) The credit shall be allowed only for taxespaid to the other state' on income derived from sources within that state which is taxable under its laws irrespective of the residence or domicile of the recipient. (Emphasis added,)

The word "state" is defined to include the possessions of the United States, such as Puerto Rico. (Rev. & Tax. Code, § 17018.)

The words which are underlined in the above excerpt from section 18001, subdivision (a) of the Revenue and Taxation Code are the ones giving rise to the disputed tax liability involved in this appeal., It is the contention of appellants that the liquidating dividends received by them in 1960 constituted income derived from sources within Puerto Rico, where the principal business of Roberts Corporation was conducted, and that they are therefore entitled to the credits claimed. Conversely, respondent argues that the liquidating dividends had their source in the corporate stock, that the situs of the stock was the residence of its owner, and that since all three appellants were domiciliaries and residents of California in 1960, the income they realized was derived from sources within California rather than from Puerto Rican sources.

In support of its contention respondent relies primarily on the 1941 decision of the California Supreme Court in Miller v. McColgan, 17 Cal, 2d 432 [110 P.2d 419]. The question before the court in that case was whether or not a credit was allowable for a Philippine income tax paid on dividends and gains received by a California resident from his stock in a corporation in the Philippine Islands. The court decided no credit was available, reasoning that the dividends and gains had their source in the stock itself, and that the situs of that stock was the residence of its owner. In reaching this conclusion the court applied the common law doctrine often followed in determining the taxable situs of intangible assets, mobilia sequuntur personam; meaning "movables follow the person."

In 1953 a California District Court of Appeal reached a contrary conclusion in Henley v. Franchise Tax Board, 122 Cal. App. 2d 1 [264 P.2d 179], holding, under very similar facts, that the taxpayer was entitled to a credit. Appellants contend that this later decision constitutes a proper interpre-'cation of the law from both legal and public policy standpoints.":;,! The Henley court reasoned, in part, that the decision in Miller v. McColgan, supra, had been based on a federal constitutional determination made by the United States Supreme Court in First National Bank of Boston v. Maine, 284 U. S . 312 [76 L. Ed . 313]. In view of the fact that the First National Bank of Boston case was specifically overruled in 1942 by State Tax Commission of Utah v. Aldrich, 316 U.S. 174 [86 L. Ed, 1358] the Henley court indicated its belief that Miller v. McColgan, supra, was no 'longer the law in California.

In Appeals of R. H. Scanlon and Mary M. Scanlon, Cal.St. Bd. of Equal., April 20, 1955, this board adhered to the position taken by the California Supreme Court in Miller v. McColgan. We based the Scanlon decision on the fact that

we were dealing there with the interpretation of a state statute and not with a federal question, The court in Miller had cited First National Bank of Boston v. Maine, supra, 284 U.S. 312 [76 L. Ed., 313] only as a guide in determining the legislative intent at the time the word "sources" was incorporated into the tax credit statute. Our California Supreme Court having established the meaning of the statute based upon decisions current at the time of its enactment, the subsequent change of position by the United States Supreme Court did not alter the interpretation. (Ware v. Heller, 63 Cal. App. 2d 817 [148 P.2d 410].) And a ruling on the law of California pronounced by the Supreme Court of this state is controlling over any conflicting decision of an inferior state court. (In re Halcomb, 21 Cal. 2d 126 [130 P.2d 841: Estate of Fleishman, 2 Cal. App. 2d 588 [145 P.2d 86].

We have consistently followed the above view in appeals which have come to us for decision since the Scanlon appeal. (See Appeals of Joseph A. and Marion Fields, Cal. St. Bd. of Equal., May 2, 1961; Appeal of Anne Bachrach, Cal. St. Bd. of Equal., July 22, 1958; Appeal of Finley J. Gibbs, Trustee, Cal. St. Bd. of Equal., July 22, 1958; Appeal of Estate of Dora A. Wood, Cal. St. Bd. of Equal., July 22, 1958; Appeal of John and Catharine. Burnham, Cal, St, Bd. of Equal.; Nov. 1, 1955.) The Attorney General of California has taken a similar Position, as is noted in the Scanlon, Bachrach and Burnham opinions, supra, and, after a thorough analysis of the matter,--has advised respondent to follow Miller v. McColgan,

In support of their respective positions, both respondent and appellants have cited several decisions rendered by the courts of sister states, some of which specifically accepted or rejected the reasoning and conclusion of our state Supreme Court in Miller v. McColgan. Our determination is in no way affected by the existence of these cases, however, for when a rule of law is clearly established by the decisions of the courts of this state, we are not at liberty to ignore it in favor of a rule established by the decisions of other states. (People v. Shea, 125 Cal. 151 [57 P. 885]; Schneider v. Schneider, 82 Cal. App. 2d 860 [187 P.2d 459].)

We see no material difference between the facts involved in these appeals and those in Miller v. McColgan and we see no justification for changing the position we have adhered to in past decisions. We therefore follow the Miller rule in concluding that the gains realized by appellants upon liquidation of their Puerto Rican corporation were derived from their stockholdings in that corporation. Under the principle of mobilia sequuntur personam, as reiterated in the

Miller decision, the situs of that stock was California, the residence and domicile of appellants, The liquidating dividends which they received were therefore derived from California sources rather than Puerto Rican sources, within the meaning of our tax credit statute, and respondent properly disallowed the tax credits.,

If the rule of the Miller case is to be changed, we believe that that change should come from the California Legislature or from the Supreme Court of this state. At the present time we are bound by the California Supreme Court's most recent declaration of California law in this area,

O R D E R

Pursuant to the views expressed in the opinion of the'board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Hugh S. and Nina J. Livie, Charles E. and Ruth A. Hopping, and Kenneth M. and Grace I. Bishop against proposed assessments of additional personal income tax in the amounts of $17,459.66, $17,417.17 and $17,585.63, respectively, for the year 1960, be and the same. is hereby sustained;.

Done at Sacramento, California, this 28th day of October, 1964, by the State Board 'of Equalization,

Paul R. Leake, Chairman

John W. Lynch, Member

Geo. R. Reilly, Member

_____, Member

_____, Member

Attest: _____, Secretary

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